

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-113259-06

Date:
May 08, 2007

Re:

LEGEND:

Grantor	-
Trust	-
Child A	-
Grandchild 1	-
Grandchild 2	-
Grandchild 3	-
Grandchild 4	-
Grandchild 5	-
Date 1	-
Date 2	-
Date 4	-
Court	-
State	-

Dear :

This is in response to a letter dated April 11, 2007, and prior correspondence, submitted by your authorized representative, requesting rulings under sections 61, 1001, and 2601 of the Internal Revenue Code.

Grantor created and funded Trust, an irrevocable trust on Date 1, for the primary benefit of Child A and Child A's issue. Under the terms of Section II, during Child A's

lifetime, net income is to be distributed to Child A. In addition, the trustee has the discretion to distribute trust principal to Child A under specified circumstances. On Child A's death, the trust corpus is to be distributed to Child A's living issue per stirpes.

Currently, Child A has four living children: Grandchild 2, Grandchild 3, Grandchild 4 and Grandchild 5, all, of whom are over age 21. Grandchild 3 has one child. A fifth child, Grandchild 1, has died survived by two children. In addition, Grandchild 5 has become permanently disabled.

On Date 2, the appropriate parties petitioned State Court to modify Trust to provide that on termination of Trust, that portion the Trust corpus otherwise passing to Grandchild 5 will be held in further trust for the exclusive benefit of Grandchild 5. Under the terms of this trust, the trustee will have discretion to distribute trust income and corpus to or for the sole benefit of Grandchild 5 during Grandchild 5's lifetime. The trust will terminate on Grandchild 5's death, at which time the trust corpus will be distributed outright or in trust pursuant to Grandchild 5's exercise of a testamentary general power to appoint the trust corpus. However, Grandchild 5 can only exercise the power in conjunction with Grandchild 2 who must approve such exercise of the power of appointment in writing. Such written approval must be executed prior to Grandchild 5's death and can not be revoked once executed, nor can it be revoked after Grandchild 5's death. If Grandchild 2 is not then living, the trust instrument provides for the substitution of specific individuals. It is represented that none of the individuals have a substantial interest in the property subject to the power that is adverse to the exercise of the power. If Grandchild 5 fails to exercise the power, then the trust corpus will be distributed to Grandchild 3 and Grandchild 4 and their heirs and assigns.

The petition also requested that the provisions relating to the compensation of the trustee and the administrative powers of the trustee be updated.

On Date 3, a conditional State Court Order was signed modifying the Trust as described above, subject to receipt by the petitioners of a ruling from the Internal Revenue Service.

Trust became irrevocable prior to September 25, 1985, and it is represented that no additions have been made to Trust after said date.

The trustee has asked for rulings that: (1) the court-approved modification will not have any effect on the Trust's status as exempt from generation-skipping transfer (GST) tax under section 2601; (2) the modification of Trust to provide for the establishment of a separate trust for Grandchild 5 on the termination of Trust will not result in a gift by Grandchild 5; and (3) no income or gain or loss will result because of the modification.

Ruling Requests 1 and 2

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under section 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of section 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph section 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

In the instant case, the modification of Trust pursuant to State Court Order provides that the trust corpus that would otherwise pass to Grandchild 5 on termination of Trust will be held in further trust for the exclusive benefit of Grandchild 5. Grandchild will have a testamentary general power to appoint the corpus of this trust to anyone, including her estate or the creditors of her estate. Although the power is exercisable in conjunction with a specified individual, or specified successors to that individual, the power will be exercisable by Grandchild 5 in conjunction with an individual who will not have a substantial interest in the property subject to the power which is adverse to the exercise of the power. Accordingly, the assets of the continuing trust will be included in

Grandchild 5's gross estate for estate tax purposes under section 2041(a)(2). Further, Grandchild will be treated as the transferor of the trust corpus for GST tax purposes under section 2652(a)(1).

Finally, the modifications pertaining to trustee compensation and trustee administrative powers are administrative in nature. See section 26.2601-1(b)(4)(i)(D).

Under these circumstances, based on the facts submitted and the representations made, we conclude that implementation of the State Court order will not cause Trust to lose its exempt status for generation-skipping transfer tax purposes.

Further, under the circumstances, Grandchild 5 will not be treated as making a gift for purposes of section 2501 if on termination of Trust her share of Trust corpus is held in trust for her exclusive lifetime benefit, and with respect to which she holds a testamentary general power of appointment.

Ruling Request 3

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution. The issue presented was whether a sale had taken place that results in the realization of gain or loss under section 1001.

The Court concluded that section 1.1001-1 reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are "materially different." Cottage Savings v. Commissioner, 499 U.S. at 560-61. In defining what constitutes a "material difference" for purposes of section 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as those in possession of the properties enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

In the present case, consistent with the Court's opinion in Cottage Savings, the interests of the beneficiaries of Trust, as modified, will not differ materially from their interests in the original Trust. In the proposed modifications, the relative interests of the beneficiaries in the Trust will not be changed. Only the timing of the termination in the case of Trust will be modified. Except for the changes described above, all other provisions of Trust will remain unchanged. Accordingly, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries, and no gain or loss is recognized on the modification of Trust for purposes of section 1001(a).

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, except as noted above, we are not ruling on the gift tax and income tax consequences of the transaction.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
George Masnik
Chief, Branch 4
(Passthroughs and Special
Industries)

Enclosure:
Copy of letter for section 6110 purposes

cc: